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No. 97-1768

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1997

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
PAINEWEBBER INC., AND DEAN WITTER REYNOLDS INC.

Petitioners,

v.

JEFFREY PHILLIP KRAVITZ, GLORIA BINDER,
AND BRUCE ZAKHEIM IRA FBO BRUCE ZAKHEIM

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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RESPONDENTS' BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the Court should review an interlocutory, unanimous en banc court of appeals decision reversing the district court's grant of summary judgment for petitioners where the court of appeals found there were contested issues of material fact about (a) the reasonable availability of better prices that petitioners deliberately failed to provide when executing trades for their customers, and (b) whether petitioners knowingly or recklessly deceived their customers by not disclosing their execution practices or the profits they made for themselves at the expense of their customers.

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RESPONDENTS' BRIEF IN OPPOSITION

STATEMENT OF THE CASE

Respondents brought this case as a class action on behalf of customers of the three petitioner securities broker-dealers. Respondents claim that at least from November 1992 to November 1994 (the "Class Period"), the petitioners fraudulently obtained undisclosed profits by executing the

respondents' market orders to buy and sell NASDAQ stocks at so-called "NBBO" prices rather than at better prices that were reasonably available -- and that the petitioners used when trading for their own accounts.

The Third Circuit en banc voted unanimously (10-0) to reverse the district court's grant of summary judgment for the petitioners, ruling that material issues of fact are in dispute.

The Third Circuit's ruling does not warrant review. This case comes here in an interlocutory posture, was decided correctly, breaks no new ground, and conflicts with no decision of this Court or any other court of appeals.

1. Background. Respondents are investors who placed market orders with petitioners to purchase or sell stocks listed on the electronic system known as the National Association of Securities Dealers Automated Quotation system, or "NASDAQ." Petitioners are broker-dealers; they accept stock orders from the public and also make markets in NASDAQ stocks trading from and for their own accounts. NASDAQ displays quotes offered by market makers for specific stocks. Market makers trade those securities with the public at bid and ask (buy and sell) prices. The bid price is generally lower than the ask price. The market maker is compensated for its commitment of capital and the trading risk it incurs -- i.e., the risk that the market will move against it -- by the spread between bid and ask prices. Pet. App. 43a. The highest bid and lowest ask prices entered by market makers on the NASDAQ system for each stock are called the "NBBO" -- national best bid and offer -- prices. Id. 43a-44a.[1]

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[1]A market maker is also compensated for executing customer orders by charging a markup on top of the execution price (or, in the case of a sale, a markdown). The markup or markdown is earned regardless of the spread.

Respondents' Amended and Consolidated Class Action Complaint (the "Complaint" or "Cplt.") alleges that during the Class Period the petitioners secretly profited at respondents' expense by executing the respondents' market orders at NBBO prices even when better prices were reasonably available to petitioners from sources other than the NBBO, including other electronic trading systems such as Instinet (a private network owned by Reuters Holdings PLC) and SelectNet (a computer exchange service owned by NASDAQ), systems which petitioners used in executing trades for their own accounts. App. 19-43.[2] In particular, the Complaint alleges that the petitioners, without disclosure to their customers:

> bought stock for their own accounts from customers at prices lower than otherwise reasonably available market prices from alternative sources like Instinet, and sold stock from their own accounts to their customers at prices higher than otherwise reasonably available market prices (Cplt. ¶33, Pet. 31-32);
>
> executed co-existing market orders to sell and to buy shares of the same stock at NBBO prices (thereby obtaining the spread between the NBBO prices without incurring any risk), rather than crossing the orders and executing them at a price within the NBBO spread and hence superior to NBBO prices (Cplt. ¶¶34, 35, Pet. 32-34);

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[2]"App." refers to the Appendix To Brief Of Appellants respondents filed in the Third Circuit.

> executed market orders at NBBO prices despite the existence of corresponding limit orders from other customers for shares of the same stock at better prices (Cplt. ¶36, Pet. 34); and
>
> routed customers' market orders, in return for consideration, to other market makers who executed them at the NBBO regardless of the reasonable availability of better prices (Cplt. ¶38, Pet. 35).

See Pet. App. 38a-41a, 84a-85a.[3]

Respondents alleged that petitioners' undisclosed practice of profiting by executing respondents' orders at the NBBO even when petitioners knew better prices were reasonably available violated Section 10(b) of the federal Securities Exchange Act of 1934 and Rule 10b-5 promulgated

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[3]The following example illustrates the kinds of conduct at issue here: If the NBBO for a particular stock was $43 bid and $44 asked, and a customer placed a buy order with one of the petitioners, the petitioner would charge the customer $44 (plus a dealer's markup). A customer placing a sell order would be paid $43 (less a dealer's markdown). The petitioner would keep the $1 per share spread between the bid and ask NBBO quotes (plus the markup and markdown). Respondents allege that the petitioner would have executed the trade at NBBO prices even if it knew there were better execution prices otherwise reasonably available on Instinet or SelectNet for the same stock at $43 1/4 bid and $43 3/4 asked. Cplt. ¶33, App. 31-32.

In this case, by executing the orders at the NBBO prices rather than at the better Instinet or SelectNet prices (the best reasonably available prices), petitioner would take a total spread of $1.00 (the difference between $43.00 and $44.00), instead of the legitimate $0.50 spread between the best reasonably available execution prices on Instinet or SelectNet (reflecting the true risk to the petitioner), and thus extract an undisclosed profit of $0.50, i.e., $0.25 per share from each of its customers at no risk to itself.

thereunder because: (a) it meant that the petitioners knew that their implied representations that respondents' orders would be executed at the best reasonably available price were in fact false; and (b) petitioners fraudulently omitted to disclose all material facts in connection with their execution of respondents' trades. Cplt. ¶¶39-45, App. 35-37.

2. Summary Judgment. Petitioners initially filed a motion to dismiss. App. 45-47. After the motion was briefed and argued, the district court sua sponte converted it into a motion for summary judgment. Pet. App. 86a-88a. The court gave the parties six weeks to submit supplemental briefs and affidavits addressed to the limited areas of petitioners' execution of respondents' market orders and relevant market practices and regulatory requirements. Id. Respondents were given no opportunity to depose petitioners' witnesses or to otherwise engage in document discovery on the summary judgment motion, nor had the district court permitted any discovery prior to that point.

In the district court, the petitioners expressly conceded that they had made an implied representation to the respondents that they would charge them "fair prices" (Pet. App. 67a) and admitted during oral argument that they "had an obligation of best execution to the retail orders that they accept from people like the plaintiffs." Transcript (Sept. 11, 1995) at 4, App. 194.[4] The petitioners contended, however, that their exclusive use of NBBO prices satisfied their duty of best execution in all cases. Pet. App. 49a.

Respondents contested that assertion with contrary declarations from Richard Y. Roberts, a Commissioner of the

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[4]See also Pet. App. 68a (petitioners do not dispute "that fairness includes a duty of best execution.").

Securities and Exchange Commission ("SEC") during the Class Period, Junius W. Peake, a former Vice-Chairman of the National Association of Securities Dealers ("NASD") Board of Governors and a securities industry expert, and Paul M. Lacy, a retired NASDAQ trader with over 32 years of experience in the industry. Pet. App. 51a-53a.

Mr. Roberts declared that a broker-dealer who, during the relevant period, automatically executed a customer order at the NBBO price when better prices were reasonably available on Instinet or SelectNet "failed to fulfill its duty of best execution." Roberts Dec. ¶ 7, App. 777. Mr. Peake agreed, declaring that when prices superior to the NBBO are reasonably available through Instinet or SelectNet, or offsetting market or limit orders, "the failure to execute customer market orders at those superior prices does not fulfill a broker-dealer's duty of best execution." Peake Dec. ¶ 6, App. 758. Mr. Lacy declared that he had always understood the duty of best execution to require a broker-dealer to obtain the best price from all reasonably available sources, including Instinet and offsetting market and limit orders. Lacy Dec. ¶¶ 4,5,8,10, App. 718-721.

Mr. Lacy ended his career with a 17 year term at Drexel Burnham Lambert, where he was a Vice President, Over-the-Counter Securities Trader, responsible at any given time for making markets in over 30 securities. Lacy Dec. ¶ 3, App. 718. In executing market orders for those securities, he consistently checked prices available from sources other than the NBBO, including Instinet. Id. at ¶¶ 4-10, App. 718-21. "At no time did [he] ever automatically execute a customer's retail market order at the NBBO if a better price existed through any other reasonably available alternative price source, including Instinet." Id. at ¶ 10, App. 721.

In granting summary judgment, the district court ruled, as the petitioners had acknowledged, that they owed the respondents a duty of "best execution." Transcript (Sept. 11, 1995) at 4, App. 194. The district court went on to hold, however, that the duty of best execution had "no precise meaning ... with respect to exclusive use of the NBBO." Pet. App. 68a. The court's holding was based on the absence of any SEC or NASD "rule, regulation or interpretation of a regulation which directly addresses the question of whether exclusive reference to the NBBO satisfies that [best execution] duty." Id. at 70a. The court further held that "[a]ttempts to rely on industry custom to clarify the prevailing standard for duty of best execution ... are similarly of no avail. The affidavits supplied by the parties on market practices predictably contradict each other ... ." Id.

The district court's holding that the duty of best execution was unclear led it to conclude that, as a matter of law, the petitioners could not have made any misrepresentations on that subject. Id. at 72a. The court also concluded that, even if the petitioners had made misrepresentations, as a matter of law they did not act with the requisite scienter because there was no SEC or NASD rule expressly referring to the practice of executing market orders solely at NBBO prices. Id. at 74a.

Finally, the court said that judicial consideration of the respondents' claims would not "be appropriate" in light of new order execution rules the SEC proposed after the parties had briefed the petitioners' motion to dismiss. Id. at 78a. The new rules (which were adopted on August 28, 1996) expressly require broker-dealers to execute at "the best prices available from all sources, including SelectNet and Instinet" and to cross certain retail market orders and limit orders. Id. at 77a (emphasis in original). The SEC's adoption of prospective

rules (after the Class Period) persuaded the court that it should defer to the regulators.

3. The Panel Decision. Initially a panel of the court of appeals affirmed. Focusing on scienter, Judge Nygaard and District Judge Mazzone (sitting by designation) held that, because the petitioners had been under no existing regulatory or judicially announced duty to disclose their practices of executing exclusively at NBBO prices, "and those practices are widely followed within the securities industry, as a matter of law there is no scienter when defendants fail to disclose those practices." Pet. App. 25a. Judge Stapleton dissented. Id. at 28a.

Respondents sought rehearing en banc. The SEC simultaneously sought a modification of the panel opinion because the panel suggested that a practice cannot be actionable under the securities fraud laws "if it is 'pervasive' or 'widely followed' in the securities industry." Request of the SEC, Amicus Curiae, For Modification of Panel Opinion (July 11, 1997) at 3. On the contrary, the SEC urged, "if the evidence shows that the defendant acted with intent to deceive or in reckless disregard of whether persons would be misled, it should not be a defense to a fraud charge that others are engaging in the same illegal practice, even on a widespread basis." Id.

4. The En Banc Decision. The court of appeals granted en banc review and, Judge Nygaard having been persuaded, unanimously reversed the district court's grant of summary judgment.

(a) The court began its analysis by noting the parties' agreement that a broker-dealer impliedly represents to its customer that the customer's market order will be executed in

a manner consistent with the duty of best execution and that a broker-dealer who accepts such an order while intending to breach that duty makes a representation that is material to the purchase or sale.

Pet. App. 5a. The court also ruled that "the duty of best execution requires the defendants to execute the plaintiffs' trades at the best reasonably available price." Id. at 7a (footnote omitted).

The en banc court disagreed, however, with the district court's ruling that the best execution duty was too vaguely defined to be enforceable. Rather, the court held:

> While ascertaining what prices are reasonably available in any particular situation may require a factual inquiry into all of the surrounding circumstances, the existence of a broker-dealer's duty to execute at the best of those prices that are reasonably available is well-established and is not so vague as to be without ascertainable content in the context of a particular trade or trades.

Id. at 7a-8a. In so holding, the court had the full backing of the SEC. In the first of three amicus curiae briefs it filed in the appellate court,[5] the SEC noted that it had "explained and discussed the duty [of best execution] in a variety of contexts and in a number of releases and reports over the years," and that the duty had "long been recognized as enforceable through the antifraud provisions of the federal securities laws." Brief

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[5]The first brief was filed with the panel. The second requested modification of the panel opinion. The third, mentioned below, was filed with the full court after rehearing en banc was granted.

of the SEC, Amicus Curiae (Oct. 1996), at 4-5 (footnotes omitted). The SEC added that

> the determination of whether a broker-dealer has provided best execution depends on the facts and circumstances, including what prices are readily available in a particular situation, and ... such facts and circumstances may change over time. That does not mean, however, that the [best execution] duty is too vague or indefinite to be capable of enforcement under the antifraud provisions.

Id. at 8-9 (footnote omitted).

The court then noted that, after the Class Period, the SEC had issued rules "that altered the definition of the NBBO to include consideration of many of the alternative sources of liquidity that plaintiffs claim should have been consulted during the class period, such as SelectNet and Instinet." Pet. App. 8a (citing Order Executions Obligations, Exchange Act Release No. 37,619A, 61 Fed. Reg. 48290, 48306-16 (Sept. 12, 1996)). Neither the court nor the SEC believed that its proposal or adoption of the new rules answered the question whether the petitioners had committed fraud during the Class Period. As the SEC told the court, the fact that it "was considering (and has now adopted) rules that prospectively affect a broker-dealers' order handling obligations would not make it appropriate for the court to abstain from deciding whether the defendants committed fraud with respect to that obligation as it existed during the period at issue in this case." Brief of the SEC, Amicus Curiae (Oct. 1996) at 12 n.14.

The court also noted that the duty of best execution "has evolved over time with changes in technology and

transformation of the structure of financial markets" (Pet. App. 8a)(footnote omitted) and that "broker-dealers have long been required to conform [their] order practices with changes in technology and markets" (id. at 8a-9a). This, too, was supported by the SEC, which told the court that whether a broker-dealer has satisfied the best execution duty

> has always depended on the facts and circumstances at the time of the trade, and ... it was understood during the class period that broker-dealers had an obligation to periodically assess whether better execution might reasonably be available away from the Nasdaq system. It is thus impossible to state categorically that execution at the NBBO always satisfied the best execution requirement.

Supplemental Brief of the SEC, Amicus Curiae (Nov. 21, 1997) (erroneously dated Nov. 1996) at 2 (footnote omitted).

(b) Having ruled that the duty of best execution is judicially enforceable in this case, and that broker-dealers are required periodically to assess and modify their practices in light of changing circumstances "if necessary to enable their clients to obtain the best reasonably available prices" (Pet. App. 9a), the court then reviewed the record regarding the reasonable availability to petitioners of prices superior to the NBBO during the Class Period. The court noted that both SelectNet and Instinet were in existence throughout the Class Period, that "the defendants themselves actively traded" for their own

accounts through those services, and that "other respected members of the brokerage community ... have regarded these services as providing reasonably available prices" and have used them "when the prices reported were more favorable to the client than the NBBO price." Id. at 10a.[6]

This record evidence led the court to conclude that whether better prices were reasonably available to the petitioners during the Class Period was a question of material fact in dispute; that a finder of fact might conclude that better than NBBO prices actually were reasonably available; and that the same fact finder might conclude that the petitioners' insistence on using inferior NBBO prices, and their refusal to so advise the respondents, made false their representation to the respondents that they would execute their trades in accordance with the duty of best execution. Id. at 10a-12a.

(c) The court then turned to the issue of scienter. It noted the respondents' evidence that other members of the brokerage community refused to rely exclusively on NBBO prices; that "an SEC study found clear evidence of a two-tiered market during the class period, in which NASDAQ market makers routinely traded at one price with retail clients like the [respondents] and at a better price for themselves through quotation services like SelectNet and Instinet"; and that "the possibility that the duty of best execution might require resort to sources other than the NBBO was being actively debated during the class period" and that the debate resulted, after the

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[6]The court also noted that an SEC study of prices on NASDAQ stocks from April through June 1994 found that "'approximately 85% of the bids and offers displayed by market makers in Instinet and 90% of the bids and offers displayed on SelectNet were at better prices than those posted publicly on NASDAQ.'" Pet. App. 10a. (quotation omitted).

Class Period, "in a [SEC] regulation effectively requiring as much." Id. at 13a.

"All of this would allow," the court concluded, "a reasonable trier of fact to find that the [petitioners'] misrepresentation" about how their execution of the respondents' orders "was at least reckless, if not intentional." Id. To be sure, the petitioners had also adduced evidence from other brokers that "their practice during the class period was the same as that of the defendants," and that evidence could be considered probative on the issue of scienter, but at this point it simply raised a material issue of fact precluding summary judgment. Id. at 13a-14a.

(d) Finally, the court held that the petitioners were not immunized as a matter of law from fraud liability even if their fraudulent practices were widely followed by other brokers (id. at 15a); and that the district court's abstention in deference to SEC expertise was wrong: "The district court was not deprived of this enforcement authority [over the securities laws] just because no court or regulator had previously chosen to exercise such authority with respect to the practice challenged here." Id. at 16a.

REASONS FOR DENYING THE WRIT

This Court normally declines review of interlocutory rulings and nothing about this case warrants an exception from that policy. The petition struggles to articulate a conflict between the decision below and a decision of this Court or another court of appeals, but none exists. Nor is there anything worthy of certiorari in the two principal arguments urged by the petition.

The first of those arguments is that the unanimous decision below allows a finding of liability for practices supposedly sanctioned by regulators and followed by others in the industry. Pet. 15-16. The first prong of that contention is incorrect and the second is unremarkable.

The mantle of regulatory approval never existed. Both the district court and the court of appeals were agreed on that score.[7] The SEC itself told the court of appeals that it is "impossible to state categorically that execution at the NBBO always satisfied the best execution requirements" (Supplemental Brief of the SEC, Amicus Curiae (Nov. 21, 1997) at 2) and that its recent rulemaking regarding broker-dealers' obligations in executing market orders does not mean that the courts should "abstain from deciding whether the defendants committed fraud with respect to that obligation as it existed during the period at issue in this case."[8]

As for industry practice, the court of appeals rightly rejected the bold notion that a thing cannot be fraud if "everyone" does it: as the SEC noted, such a rule would "erroneously legitimize widespread fraudulent conduct charged

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[7]The Third Circuit found:

> [T]here is no statute, rule, regulation or interpretation, by the SEC or by a court, that authoritatively establishes that, for all trades, the NBBO exhausted the category of "reasonably available prices" during the class period.

Pet. App. 15a. Similarly, the district court found "neither Congress, the SEC nor the NASD has issued a definitive statement on point concerning use of the NBBO as satisfaction of the duty of best execution." Pet. App. 48a (footnote omitted).

[8]Brief of the SEC, Amicus Curiae (Oct. 1996) at 14 n.14.

in future cases brought either by the Commission or by private parties."[9]

The petitioners' second principal contention is that review is warranted because the decision below supposedly opens the floodgates to plain breach of duty cases disguised as fraud cases. Pet. 23-27. But the petitioners admit that they made implied representations to the respondents in accepting their market orders and they admit that they owed respondents a duty of best execution. Pet. App. 5a; Transcript (Sept. 11, 1995) at 4, Pet. 194. The Complaint alleges that those representations were false and fraudulent, and that petitioners fraudulently omitted to inform respondents of their order execution practices. Those well-pleaded allegations of deceitful misrepresentations and omissions state a claim under §10(b) and Rule 10b-5 and remove this case entirely from the area marked off by Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977).

I.
REVIEW OF THE THIRD CIRCUIT'S INTERLOCUTORY FACT-BOUND RULING IS UNWARRANTED

None of the ten active judges of the court of appeals who unanimously decided this case saw in it, at its present juncture, any of the legal issues the petitioners set forth and argue in their petition for certiorari. The en banc Third Circuit unanimously concluded this case presented factual disputes that preclude judgment as a matter of law and remanded the case to the district court for further factual development. In particular, the court found disputed issues of material fact concerning (1)

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[9]Request of the SEC, Amicus Curiae, For Modification Of Panel Opinion (July 11, 1997) at 1.

whether prices superior to the NBBO were reasonably available to petitioners for executing their customers' market orders for NASDAQ stocks (Pet. App. 6a, 10a, 14a n.6), and (2) whether petitioners knowingly or recklessly acted contrary to their implied representations to their customers by not providing these better prices in order secretly to profit themselves (id. at 12a-14a). These rulings rest on the law of summary judgment and not on the law of securities regulation. They plainly do not warrant review by the Court.

Certiorari to a federal court of appeals is not ordinarily granted if the decision below is interlocutory and remands a case for further proceedings. See, e.g., Virginia Military Institute v. United States, 508 U.S. 946, 946 (1993), (Scalia, J., concurring)("We generally await final judgment in the lower courts before exercising our certiorari jurisdiction"). See also Stern, Gressman, Shapiro & Geller, SUPREME COURT PRACTICE 197 (7th ed. 1993)("in the absence of some ... unusual factor, the interlocutory nature of a lower court judgment will result in a denial of certiorari").

Obviously, if petitioners prevail after trial, their arguments will be moot. And a more complete trial record will provide a better framework in which to decide whether the evidence supporting the alleged misrepresentations and scienter is adequate under Section 10(b) and Rule 10b-5.

It is true the Court has, on occasion, granted certiorari to review interlocutory decisions by federal courts of appeals in some securities regulation cases. But the reason is not because interlocutory decisions under the federal securities laws are given special treatment. Rather, in each of the cases petitioners cite, the Court granted certiorari to resolve readily apparent conflicts among circuit courts about pure issues of law. For instance, in Central Bank of Denver, N.A. v. First

Interstate Bank of Denver, N.A., 511 U.S. 164, 170 (1994), the Court "resolve[d] the continuing confusion" over liability of aiders and abettors in civil actions under Rule 10b-5, by holding that the statute contained no basis for such liability. The other cases cited by petitioners presented legal issues that were similarly discrete and that had been directly decided by several courts of appeals with varying results. [10]

Nothing in these cases suggests that interlocutory review is appropriate where, as here, material facts are in dispute.

II.
THE THIRD CIRCUIT DECISION IS NOT IN CONFLICT WITH DECISIONS OF THIS COURT OR OTHER CIRCUIT COURTS

A. The Purportedly "Conflicting" Decisions About Scienter And Industry Custom Do Not Conflict

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[10] See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 354 (1991) (resolving 4-2 circuit split over whether to apply state or federal statute of limitations to private suits brought under Rule 10b-5); Basic Inc. v. Levinson, 485 U.S. 224, 230 (1988) (certiorari was granted "to resolve the split" over the "standard of materiality applicable to preliminary merger discussions"); Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 305 (1985) (certiorari was granted because "[t]he lower courts have divided over the proper scope of the in pari delicto defense in securities litigation"); Marine Bank v. Weaver, 455 U.S. 551, 552 (1982) (certiorari was granted to determine whether certificate of deposit and business agreement are "securities"); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 & n.12 (1976) (certiorari was granted because of circuit split on the standard for scienter in Section 10(b) cases); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 731 (1975) (certiorari was granted to determine whether, in light of the disagreement between the Ninth and other circuits, plaintiffs must have purchased or sold securities to assert a cause of action under Section 10(b)).

Contrary to petitioners' assertions (Pet. 15-18), the Third Circuit expressly followed and relied on the Court's holding in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), that scienter is a necessary element for liability under Section 10(b). Indeed, the court's ruling recognized that the respondents ultimately bear the burden of persuading the ultimate fact finder that petitioners not only failed to disclose their practice of executing market orders with exclusive reference to the NBBO, and thus misrepresented material facts about their execution of the respondents' trades, but also that the petitioners did so knowingly or with reckless disregard for the truth. See Pet. App. 12a-14a.

The three federal appellate decisions the petitioners describe as conflicting with the en banc ruling of the Third Circuit -- Platsis v. E.F. Hutton & Co., 946 F.2d 38 (6th Cir. 1991), cert. denied, 503 U.S. 984 (1992); Shivangi v. Dean Witter Reynolds, Inc., 825 F.2d 885 (5th Cir. 1987); and Messer v. E.F. Hutton & Co., 847 F.2d 673 (11th Cir. 1987) -- are not discussed or even cited in the court's unanimous opinion. Not a single Circuit Court Judge believed that the court's reversal of summary judgment conflicted with these decisions.

None of the three cited cases concerned the specific practice being challenged in this case. None was decided without a trial. Nor did any of the three cited decisions hold that "industry practice" precludes a finding of scienter so as to provide an absolute defense to a Section 10(b) fraud case under all circumstances.

Rather, in each of them, industry practice and the absence of any regulation were two of several factors that each court considered in determining whether the defendants had acted with scienter as required by Hochfelder. In contrast, in

this case petitioners argue that, absent regulation of particular conduct, industry practice is dispositive on the issue of scienter. As the court of appeals made clear, affirmance of the district court would result in a rule that "a defendant would be entitled to summary judgment even if it were her regular practice to knowingly violate the duty of best execution, so long as she could identify a sufficient number of other broker-dealers engaged in the same wrongful conduct to be able to argue in good faith that the underlying duty was 'ambiguous.'" Pet. App. at 15a.[11]

The Sixth Circuit decision -- Platsis v. E.F. Hutton & Co. -- concerned a broker-dealer's failure to disclose production credits given to the broker and markups on certain bond sales. The Sixth Circuit reversed, as "clearly erroneous," a judgment against the defendants, noting a number of factors that made the defendants' silence "innocent." Platsis, 946 F.2d at 40-41. The court expressly relied upon findings of fact after plaintiff presented evidence at trial, including findings that "the markups and credits were reasonable," and that the plaintiff had represented himself to the defendant as a "sophisticated

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[11]Petitioners are incorrect in contending (Pet. 21-23) that the court, in refusing to enshrine industry practice, imposed an expansive and unprecedented duty on broker-dealers in executing market orders. Early in its opinion, the court squarely adopted the traditional definition of the duty of best execution -- which petitioners concede they owe their customers (Pet. 4) -- as requiring a broker-dealer "to obtain for its customers the most favorable terms reasonably available under the circumstances." Pet. App. 7a. The court's subsequent references to "maximizing" the customer's gain (Pet. App. 7a, 11a-12a, 13a) did not mean that the court had adopted a new definition or fashioned a new duty. Moreover, the court's refusal to adopt petitioners' argument that industry practice is determinative was correct. As the SEC told the court, such a rule would "erroneously legitimize widespread fraudulent conduct charged in future cases brought either by the Commission or by private parties." Request of the SEC, Amicus Curiae, For Modification of Panel Opinion (July 11, 1997) at 1.

investor" who was "familiar with" the defendant's usual spreads. Id. In this case, there has been no finding that the petitioners' execution practices were reasonable or that they were disclosed or known to respondents or other members of the class. And of course there has been no discovery and no trial.

The Fifth Circuit's decision -- Shivangi v. Dean Witter Reynolds, Inc. -- also turned on a number of factors that supported a district court judgment that plaintiffs had failed to prove scienter at trial. The practices at issue -- which were alleged to result in higher commissions to the brokers for certain transactions -- were not shown to have affected the price charged the plaintiffs[12] or the broker's decision to recommend particular stocks. Id. at 889. The court held that these considerations, along with the absence of any SEC or court determination that the compensation information was material and the absence of proof that other brokers disclosed the information, supported the conclusion that scienter had not been proved. See Id.

The Eleventh Circuit's decision -- Messer v. E.F. Hutton & Co. -- involved the question whether the broker's unauthorized sale of a client's treasury bond investments violated Section 6(o)(1) of the Commodities Exchange Act. See Messer, 847 F.2d at 677. In discussing whether the "straddling" strategy employed by the broker in making the sales was a "good business decision," the Eleventh Circuit relied, in part, on its prevalence as an industry practice to protect an account against extreme losses. Id. at 679. The Eleventh Circuit's conclusion that the defendants did not engage in fraud was not, however, based solely on industry

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[12] In the present case the execution price to the respondents was increased as a result of the challenged practices.

practice but instead on findings that the defendant used the challenged strategy to protect its client from precipitous losses, that the client had been out of town and unreachable, and that there was no conflict of interest on behalf of the broker defendant. See Id..

In sum, neither the Sixth, Fifth, nor Eleventh Circuits in the allegedly conflict-creating decisions dealt with the practices involved in this case, and each was decided after discovery and the presentation of evidence during trial.

B. The Third Circuit Ruling Is Consistent With Santa FeIndustries, Inc. v. Green

In Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977), minority shareholders of a corporation facing the buy-out of their shares in a short form merger bypassed their right to challenge the buy-out price by an appraisal action in state court and sued under Section 10(b) and Rule 10b-5. See Id. at 467-68. The question presented was whether "breaches of fiduciary duty by a majority against minority shareholders without any charge of misrepresentation or lack of disclosure" were actionable under Section 10(b) and Rule 10b-5. Id. at 470 (quotation omitted). The Court held that they were not, because Rule 10b-5 only addresses deceptive or manipulative conduct. In Santa Fe, there was no deception because the shareholders "were furnished with all relevant information on which to base their decision." Id. at 474.[13]

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[13] Neither is the Third Circuit's decision inconsistent with the court of appeals rulings to which petitioners' refer. Pet. 20-21. Two of those cases, like Santa Fe, lacked any allegations of nondisclosure or misrepresentation. See Forkin v. Rooney Pace, Inc., 804 F.2d 1047, 1050 (8th Cir. 1986) ("The appellants were accurately informed about the status of the transaction at all relevant times."); Shemtob v. Shearson, Hammill & Co., 448 F.2d 442, 445 (2d Cir. 1971) (failure to state claim based on a negligent

In contrast, respondents allege in this case that the petitioners knowingly acted contrary to their implied representations and deliberately misled their customers by failing to disclose their routine practice of extracting secret profits by executing their customers' market orders at the NBBO without reference to better, otherwise reasonably available prices which petitioners knew existed and used for their own benefit. Petitioners' implied misrepresentations and failure to disclose material facts to respondents and other customers is precisely the kind of deceptive conduct that was absent in Santa Fe but which the Court recognized was otherwise enforceable under Section 10(b). Id. at 475-76 & n.15. See also United States v. O'Hagan, __ U.S. __, 117 S. Ct. 2199, 2209 (1997)("[i]n contrast to the Government's allegations in this case, in Santa Fe Industries, all pertinent facts were disclosed by the persons charged with violating §10(b) and Rule 10b-5 ... therefore, there was no deception through nondisclosure to which liability under those provisions could attach")(citation omitted); Kas v. Fin. Gen. Bankshares, Inc., 796 F.2d 508, 512-13 (D.C. Cir. 1986)(Santa Fe does not preclude a fraud action "based on a material nondisclosure or misrepresentation simply because the undisclosed facts involved might also support a breach of fiduciary duty claim"). Accordingly, it was not error for the court of appeals to refuse to order the complaint dismissed on Santa Fe grounds, and review of that refusal is unnecessary.

The ultimate determination of whether the petitioners are liable under Section 10(b) for deceiving respondents will

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failure to sell out account promptly; no allegation of scienter or intent to defraud). The third case, Banca Cremi, S.A. v. Alex Brown & Sons, Inc., 132 F.3d 1017 (4th Cir. 1997), concerned the issue of reliance, where an agent of the plaintiff testified that the subject of alleged non-disclosure was not a consideration in its decision to invest. Id. at 1037.

turn on facts that are contested in the present record. According to the court of appeals ruling, there can be liability for fraud only following a finding by the trier of fact that not only were execution prices better than the NBBO reasonably available to petitioners, but also that petitioners knew those better prices were available and intentionally withheld that information from their customers to secretly profit themselves. Pet. App. 16a. In short, the issues at this stage are factual and do not warrant review by this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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